

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

OCTOBER 13, 1999

IN RE:

PETITION OF UNITED CITIES GAS
COMPANY FOR WAIVER OF
RULE 1220-4-7-.05

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DOCKET NO. 99-00389

ORDER ACCEPTING PROPOSAL

This matter came before the Tennessee Regulatory Authority (hereafter the "Authority") at a regularly scheduled Authority Conference held on July 13, 1999, for consideration of the petition filed on June 2, 1999, by United Cities Gas Company (hereafter "United Cities" or the "Company") requesting permission to use an alternative procedure to that specified in Rule 1220-4-7-.05 of the Authority's Purchased Gas Adjustment (hereafter "PGA") Rules. Rule 1220-4-7-.05 requires any local gas distribution company (hereafter "LDC") with operating revenues in excess of \$2,500,000 to have an audit of the prudence of the LDC's gas purchases by a qualified consultant. Through its request, the Company seeks permission to use an alternative procedure in place of the prudence audit of its gas purchases during the years ended March 31, 1998 and March 31, 1999.

BACKGROUND

On May 12, 1995, the Tennessee Public Service Company (hereafter "TPSC") approved a performance based ratemaking mechanism (hereafter "PBR" or the "mechanism") for United Cities. The mechanism was approved for an experimental two-year period beginning April 1,

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1995, and ending on March 31, 1997. In its Order dated May 12, 1995, the TPSC specifically waived the requirement for annual prudence reviews during the experimental period.

On February 16, 1999, the Authority unanimously agreed to allow the Company to continue to operate permanently under the PBR, as modified by the Directors during their deliberations. The permanent plan would begin on April 1, 1999, and continue each year thereafter unless the PBR mechanism is either (a) terminated at the end of a Plan Year by not less than ninety (90) days notice by United Cities to the Authority, or (b) is modified, amended, or terminated by the Authority.

Since the permanent plan was not approved to begin until April 1, 1999, and the experimental period of the plan expired March 31, 1997,¹ the prudence audit requirement of the PGA Rules was in effect for the period of April 1, 1997, through March 31, 1999. The Company has proposed, in its current petition, an alternative to the hiring of a consultant to perform a prudence audit for the two-year period during which the PBR was not in effect.

REQUIREMENT FOR PRUDENCE AUDITS

The PGA Rules permit an LDC to pass through to its customers its total cost of gas for delivery to those customers. As a safeguard to ensure that the gas cost purchasing decisions of an LDC are being made in a prudent manner, Rule 1220-4-7-.05(1)(a) of the PGA Rules requires the LDC to contract with a qualified consultant to evaluate and report annually to the Authority on the prudence of any gas costs included in the PGA. The cost paid to the consultant by the LDC is

¹ The TPSC's Order of May 3, 1996, approving the PBR for a second year, was appealed by the Consumer Advocate Division of the Office of the Tennessee Attorney General on June 27, 1996. The TPSC's Order was vacated and the matter was remanded to the Authority on March 5, 1997, for further proceedings. The Authority rendered a decision on the second year of the PBR on August 18, 1998, and on the permanency of the PBR on February 16, 1999.

recorded in the LDC's Deferred Gas Cost Account and is recovered from the ratepayers through the procedures set forth in the PGA rules.

Within ninety (90) days after receipt of the consultant's prudence audit report, the Authority, in its discretion, may order a hearing to review the prudence of an LDC's gas purchasing practices. Should the Authority determine, as a result of the hearing, that any gas costs are imprudent, the Authority may order the LDC to refund any such imprudent gas costs to the ratepayers. If such a hearing is not ordered within the ninety (90) day period, the Company's gas purchasing practices are deemed to be prudent.

Prior to the implementation of the PBR, an independent consultant performed United Cities' prudence audits. One method of analysis utilized by the consultant compared the Company's gas purchases to similar industry indexes which are used in the Company's permanent PBR plan.² Each audit found that United Cities had demonstrated overall prudence in its gas supply procurement.

UNITED CITIES' PROPOSAL

In its current petition, in lieu of hiring an independent consulting firm to perform a prudence audit and having the ratepayers bear the cost of such an audit, the Company has proposed that, as a measure of prudence, the gas purchases during the two (2) years in question be compared to the same "reasonableness zone" approved by the TRA in the permanent plan. The

² During the experimental period in which the requirement for prudence audits was waived, the TPSC set a reasonableness zone for the gas procurement mechanism of 98% to 102% of the average of the three indices (NYMEX, Inside FERC, Natural Gas Intelligence). Any gas purchases that fell within this zone were not included in the computation of gains or losses. In approving the permanent PBR, the TRA modified the lower end of the reasonableness zone from 98% to 97.7% but maintained the upper end of the reasonableness zone by allowing it to remain at 102%.

Company has further proposed that to the extent that United Cities purchased gas at a cost in excess of 102% of the average of the three indices, it would provide justification to the Authority that those purchases were, in fact, reasonable and prudent.

OPINION OF THE AUTHORITY

TRA Rule 1220-4-7-.05 requires that a prudence audit of United Cities' gas purchases be conducted, consistent with the provisions set forth therein, "[u]nless otherwise ordered by the [Authority]..." United Cities has requested that the Authority exercise its discretion, allowed by Rule, in permitting the Company to pursue a less timely and less costly alternative to the hiring of a consultant to evaluate and report on the prudence of gas costs included in the Company's PGA.

United Cities' request does not *per se* seek an absolute waiver of the Rule's requirement that gas purchases be audited for reasonableness and prudence, but instead offers an alternative that complies with the intent of the Rule, and is consistent with the zone of reasonableness approved for the Company's PBR on a going forward basis.

During its deliberations on the permanency of the PBR mechanism, the Authority determined a zone of reasonableness in which the gas purchases of United Cities would not be included in the computation of gains or losses resulting from the PBR mechanism. The Authority now finds that the use of the same zone of reasonableness is also appropriate to evaluate the prudence of the Company's purchases during the two (2) years ended March 31, 1998 and March 31, 1999. Therefore, the Authority unanimously agreed to accept the Company's proposal.

IT IS THEREFORE ORDERED THAT:

1. United Cities' request to use an alternative procedure in lieu of the performance of prudency audits for the years ended March 31, 1998 and March 31, 1999, is granted.

2. United Cities will submit to the Authority a filing for the years ended March 31, 1998 and March 31, 1999, with proper documentation similar to the filings which the Company submitted to the Authority for the experimental period of the PBR.

3. All gas purchases that are at a cost less than 102% of the benchmark established for the experimental period of the PBR will be deemed to be prudent.

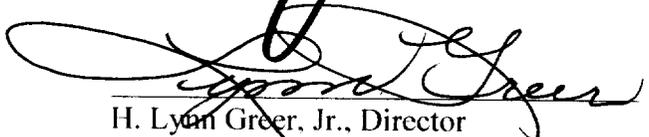
4. United Cities will bear the burden of proving to the Authority that any gas purchase in excess of 102% of the benchmark was prudent and reasonable.

5. If United Cities fails to sufficiently demonstrate to the Authority that any gas purchase in excess of 102% of the benchmark was prudent and reasonable, United Cities will credit the cost of such purchase to the Company's deferred gas cost account during the Actual Cost Adjustment audit then in progress.

6. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within ten (10) days from the date of this Order.



Melvin J. Malone, Chairman



H. Lynn Greer, Jr., Director



Sara Kyle, Director

ATTEST:



K. David Waddell, Executive Secretary